CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 347

January 14, 1971

TAXES PAID TO OTHER COUNTRIES

Syllabus:

The Canadian nonresident withholding tax on dividends is a tax on or according to or measured by income or profits and is not deductible under Section 17204.

The United Kingdom tax withheld on corporate dividends is not equivalent to the corporate income tax imposed in the United States therefore the recipient of a dividend must include in income the gross amount without deduction for the sum withheld.

The beneficiary of a United Kingdom trust which receives dividend income subject to the United Kingdom withholding tax is taxable on the actual amount of income distributed or distributable to him.

Advice has been requested as to whether recent changes in the laws of Canada and the United Kingdom affect the deductibility or excludability for the purposes of the California Revenue and Taxation Code of taxes withheld on dividends.

The State Board of Equalization in the Appeal of Georgica Guettler, Cal. St. Bd. of Equal., April 1, 1953, CCH 200-212, P-H 58,079 and the Appeal of Edward Meltzer and Freda Meltzer, Cal. St. Bd. of Equal., April 1, 1953, CCH 200-213, P-H 58,081 construed a section of the then existing Canadian withholding tax on non-resident as being a tax on gross receipts and therefore deductible under Section 17204. Consequently, the Franchise Tax Board considered the Canadian nonresident withholding tax on dividends a foreign tax deductible under Section 17204. In 1968 the sections of the Canadian Income Tax Act dealing with the nonresident withholding tax were amended and the language upon which the Guettler and Meltzer decisions were based was deleted. Therefore, it has been determined that the Canadian nonresident withholding tax on dividends is no longer deductible under Section 17204.

In 1965, the United Kingdom established a two tier tax system similar to the one employed in the United States by enacting a corporate income tax. Prior to the 1965 changes the Franchise Tax Board, relying upon the case of Biddle v. Commissioner, 302 U.S. 357 (1938), had treated the United Kingdom withholding tax on dividends as a corporate income tax which was excludable by the dividend recipient from the gross amount of the dividend declared. With the adoption of the two tiered system in 1965 the rationale of the Biddle decision has been removed. The United Kingdom withholding tax on dividends is now similar to the Mexican withholding tax on dividends. The State Board of Equalization in the Appeal of William E. and Esperanza B. Mabee, January 4, 1966, CCH 203-137, P-H 58,402, held that the Mexican tax withheld on dividends was not excludable by the recipient in reporting the amount of dividends received and was not deductible under Section 17204. Therefore, the United Kingdom withholding tax on dividends is not excludable by the recipient in reporting the amount of dividends received.

In the United Kingdom a trust is treated as a separate taxable entity which is credited with the tax withheld on dividends paid to it. The beneficiary of the trust is not considered to be taxable upon income received from the trust, the trust does not deduct from its income amounts distributed to beneficiaries, and the beneficiaries do not receive credit for the dividend taxes withheld. Therefore, the beneficiary of a United Kingdom trust is to report, for California purposes, only the actual amounts distributed or distributable to him.